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Supreme Court, U.S.
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In The

SUPREME COURT OF THE UNITED STATES

GRAY DAVIS, GOVERNOR OF THE
STATE OF CALIFORNIA,
Petitioner,

v.

DUKE ENERGY TRADING AND MARKETING, L.L.C.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

BILL LOCKYER
Attorney General of the
State of California
RICHARD M. FRANK
Chief Assistant Attorney General
MORRIS BEATUS
Senior Assistant Attorney General
JOHN A. SAURENMAN*
Supervising Deputy Attorney General
*Counsel of Record
300 South Spring Street
Los Angeles, California 90013
Telephone: (213) 897-2702
Counsel for Petitioner

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QUESTIONS PRESENTED

1. Whether the Court of Appeals for the Ninth Circuit impermissibly narrowed this Court's holding in *Idaho v. Coeur d'Alene Tribe*, 521 U.S. 261 (1997), by ruling that the Eleventh Amendment does not bar a private federal action seeking to enjoin the Governor of California from exercising his emergency powers in a time of crisis to commandeer private property in order to protect the health and safety of California's residents?

2. Whether Court of Appeals for the Ninth Circuit improperly found that the Federal Power Act preempted the Governor of California from exercising his emergency powers to protect the health and safety of the residents of California from electricity shortages?

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INTRODUCTION

This action goes to the heart of a state's sovereignty because it involves a governor's actions to protect the health and welfare of the citizens of his state in a time of crisis. Here, Gray Davis, Governor of California ("the Governor"), commandeered two block forward market contracts ("the contracts") for the delivery of electricity in order to keep that power within California and thus to prevent electricity blackouts and to protect the welfare of the residents of California.

Respondent Duke Energy Trading and Marketing ("Duke") sued in district court to enjoin the Governor's actions because, Duke alleged, the Governor had prevented the liquidation of the contracts and thus impaired Duke's security interest in the contracts. Although the district court dismissed Duke's action, the Ninth Circuit reversed, finding that the Eleventh Amendment did not bar the lawsuit and, in effect, authorizing the district courts to second guess and undo a governor's emergency actions. The Governor filed his petition for writ of certiorari seeking this Court's review of this important issue regarding the ability of the federal judiciary to review and overturn a governor's legitimate exercise of state police powers at a time of crisis.

Duke concedes that this action is not moot but only because it now is using the Ninth Circuit's opinion to assert damage claims against the State. Duke is now contravening Eleventh Amendment doctrine that the state may not be sued in federal court for retrospective monetary relief. Duke then proceeds to attempt to dismiss the seriousness of the energy crisis which California faced at the time of the Governor's actions, to ask this Court (without any support) to assume that the crisis has passed and to argue (again without support) that the crisis could never recur. Therefore, Duke contends that the specific crisis at issue in this case will not arise again and that the Ninth Circuit's severe limitation on sovereign immunity does not need to be

addressed and resolved. The simple fact of the matter is that the California electricity crisis has not ended, and other crises may arise which will require a similar response from state government. However, the Ninth Circuit has authorized broad federal court intrusion into the affairs of state government at times of crisis to the detriment of the states. Under this Court's teaching in *Idaho v. Coeur d'Alene Tribe of Idaho*, 521 U.S. 261 (1997), judicial intrusion into such a core area of state sovereignty should not be permitted.

I.

Coeur d'Alene Is Plainly Applicable Here.

In the Governor's petition for writ of certiorari, we showed why this Court should accept this matter and resolve the serious questions which it presents concerning the Eleventh Amendment. We stand by those arguments and respond only briefly to several of Duke's arguments in opposition.

A. This Case Involves A Core Area of State Sovereignty.

In its opposition, Duke takes the extraordinary position that the Governor cannot take steps to protect California residents, who are the victims of the state's ill-conceived electricity deregulation plan. This is an evisceration of state sovereignty.

In *Coeur d'Alene*, it was the unique divestiture of the state's broad range of controls over its own lands that made the *Ex parte Young* exception to sovereign immunity inapplicable. Here, the state's ability to control a crisis affecting the health and safety of its residents which arises from the state's dysfunctional energy markets is no less sovereign.

Moreover, nothing is more of a "core function" of state sovereignty than the ability to seize private property (subject to fair compensation) to protect the public interest – a concept which has been established in American jurisprudence for well over a hundred years. *See, e.g., Bowditch v. Boston*, 101 U.S. 16 (1879) (city not liable for destroying plaintiff's building to prevent spread of fire). Acting to protect the public in time of crisis is the ultimate exercise of the police power. The Ninth Circuit's opinion effectively removes that ability from the states by holding that a state is powerless to seize property if it will have any impact on rights purportedly established under federal law. Thus, according to the Ninth Circuit, a state now may not be able to seize or destroy infected crops that may threaten other crops if the crop secures a federal loan, *i.e.*, because by seizing or destroying the crops, a federal security interest may be impaired. It is for these reasons that this Court should grant this petition and determine whether *Coeur d'Alene* is applicable under these circumstances.[1]

Duke attempts to avoid the application of *Coeur d'Alene* by casting the Governor's actions as an attempt merely to save the state money. *See* Duke Opp. at 11 ("..., the Governor's interest in reducing the state's cost of electricity plainly does not implicate any 'special sovereignty interest' ....") What Duke ignores is that the Governor acted to preserve the power for the state in order to protect against blackouts. Indeed, in his executive orders commandeering the contracts, the Governor

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1. Duke makes much of the fact that California has petitioned this Court on Eleventh Amendment issues in several taxation cases in the recent past. Duke Opp. at 2-3. We continue to believe that those cases presented issues worthy of this Court's consideration. However, we also believe that this case presents an even more compelling issue because it involves the very heart of the state's power to act to protect the public welfare. Further, it is essential that this Court resolve the recurring issue of the scope of *Coeur d'Alene*.

expressly noted that a state of emergency existed; that "California's energy shortage has resulted in unanticipated power outages for California residents and for critical services in the State"; and that "it is necessary for the State to take control of the block forward market contracts ***to ensure a sufficient and continuous supply of electricity*** to meet California's energy needs and to mitigate the effects of this energy shortage." Pet.App. at A51, A53; emphasis added.

As Judge Kozinski noted in his dissent:

> The emergency affected not merely the price of electrical power, but its very availability. For the first time in its history, the state was confronted with rolling blackouts which themselves caused serious disruptions; ***there was good reason to believe that far worse was in store***.

Pet.App. at A33; emphasis added.[2]

Duke also relies on *Sterling v. Constantin*, 287 U.S. 378 (1932), to support its argument that the federal judiciary may enjoin a governor's exercise of police powers if such exercise is inconsistent with federal law. Duke Opp. at 8-9. *Sterling* is hardly apposite here. In *Sterling* the Governor of Texas declared martial law under dubious circumstances – apparently in an attempt to evade and disrupt the lawful processes which were occurring in federal court. As this Court noted:

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2. In order to create the impression that this case is about saving the State money, Duke selectively quotes a comment of the Governor which the Ninth Circuit recited. The full statement is "I am using my emergency powers to seize options to buy very inexpensive power ***that would otherwise be lost forever***." Pet.App. at A8; emphasis added. The Governor was acting to preserve energy resources for California and its residents.

> In the place of judicial procedure, available in the courts which were open and functioning, he [the Governor] set up his executive commands which brooked neither delay nor appeal. In particular, to the process of the federal court actually and properly engaged in examining and protecting an asserted federal right, the Governor interposed the obstruction of his will, subverting the federal authority.

287 U.S. at 402. Here, Governor Davis has not attempted to subvert the authority of the courts. Nor were his emergency proclamation and executive orders issued as a sham as appeared to be the case in *Sterling*. *See id.*, 287 U.S. at 390-92, 397. Rather, the Governor was acting reasonably and appropriately to protect the residents of California during a real crisis.

This petition is not about saving the state money. It is about the scope of *Coeur d'Alene* and about preserving the ability of the Governor to act at a time of crisis without the specter of federal judicial interference – interference which could place the public welfare at even greater risk. The Governor respectfully submits that the taking of private property for the protection of the general welfare in a time of crisis is just as much at the core of the state's sovereignty as is the maintaining of title to its submerged lands. As Judge Kozinski noted, "If *Coeur d'Alene* does not cover this situation, then it must apply only where Indian tribes challenge the state's title to submerged lands and nowhere else." Pet.App. at A34.

B. The Electricity Crisis Has Not Passed.

Duke has attempted to minimize the seriousness of the matter by arguing that the electricity crisis which California has

faced is over and will never recur.[3] However, Duke offers no substantiation for these assertions. Indeed, those allegations are plainly inconsistent with Duke's admission that this matter is not moot.

We agree with recent comments of FERC Commissioner Massey that "[w]hile the Western markets are behaving right now, we cannot be assured that this will continue." *California Independent System Operator Corp.*, 98 FERC 61,335 (Mar. 27, 2002). Certainly, such comments from FERC are more deserving of consideration than Duke's self-serving allegations. Additionally, the Governor has not lifted the state of emergency which he announced on January 17, 2001. The simple truth is that while we may hope that the electricity shortages which California faced last year may not recur, there is no basis for assuming that they will not return. And regardless whether the critical electricity shortages do or do not return, emergencies affecting other vital state health and safety matters will certainly occur, as will the question of the scope of state sovereignty in allowing officials to address those crises pursuant to state law.

C. As the State Argued Below, Duke is Actually Seeking Retrospective Monetary Relief.

Before the Ninth Circuit, the Governor noted that in reality Duke was seeking to use this action as a means of obtaining retrospective monetary relief. The Ninth Circuit dismissed that notion summarily, stating that "Duke's attempt to collect the IOUs' [investor-owned utilities] defaulted obligations in no way represents an effort to invade the State's fisc nor to obtain any

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3. According to recent press reports, Enron and other energy suppliers and marketers manipulated the market in order to create artificial shortages. Duke offers no assurances that such manipulations will not recur.

other retrospective remedy against the State." Pet.App. at A17-A18. However, Duke has now shown its hand.

In mid-April, 2002, Duke filed a cross-complaint in Sacramento County Superior Court seeking damages from the state based on the Ninth Circuit's opinion. A copy of that cross-complaint is appended hereto as Appendix J. In that cross-complaint, Duke admits that during the remaining term of the BFM contracts, the state paid it according to the contracts. Pet.App. at A67-A68. However, Duke further asserts that had the California PX been allowed to liquidate the contracts, it "would have resulted in hundreds of millions of dollar being made available to cover the defaults of Edison and PG&E." *Id.* at A68. Duke describes the relief it seeks as a "judgment against the State of California for the fair market value of the block forward contracts at the time of their seizure, an amount in excess of $700 million." Pet.App. at A72.[4]

The fact that Duke is seeking compensation in state court would not normally be of any great moment. What distinguishes Duke's cross-complaint, however, is that it is using the Ninth Circuit's opinion as a sword and alleging that because of that decision, it is absolutely entitled to compensation from the state. *See, e.g.*, Pet.App. at A60 ("The ruling of the . . . Ninth Circuit is conclusive on the illegality of the seizure orders."). Thus, Duke is taking a lawsuit purportedly limited to prospective injunctive and declaratory relief against the Governor and using it to obtain retrospective monetary relief against the State of California. Even the Ninth Circuit has recognized that such a position is contrary to the limited *Ex parte Young* doctrine. *See*,

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4. Interestingly, Duke does not seek damages against the Governor for his allegedly illegal acts. Rather, having obtained an injunction against the Governor, Duke seeks monetary relief against "the State of California" for at least $700 million.

e.g., *Natural Res. Def. Council v. Cal. Dept. of Transp.*, 96 F.3d 420, 422 (9th Cir. 1996).

This Court has been clear that compensatory or deterrence interests are insufficient to overcome the dictates of the Eleventh Amendment. *See Papasan v. Allain*, 478 U.S. 265, 277, 278 (1986); *Green v. Mansour*, 474 U.S. 64, 68 (1985). And indeed, in *Coeur d'Alene*, Justice O'Connor in her concurrence and Justice Souter in his dissent both made the same point, *i.e.*, the federal courts should not be used as a means of obtaining compensation or other retrospective relief for violations past. *Coeur d'Alene*, 521 U.S. at 288, 299.

Here, Duke is using the federal judiciary as a means of securing retrospective compensatory relief against the State. That Duke is doing so through two lawsuits rather than one should be of no moment. However one looks at the scheme, Duke has used the federal judiciary to attempt an end run around California's sovereign immunity. Duke should not be allowed to do so.

II.

THE FEDERAL POWER ACT DOES NOT PREEMPT THE GOVERNOR'S ORDERS.

Duke asserts that the Ninth Circuit was correct in finding a complete bright line in the Federal Power Act which preempted the Governor's orders here. Duke is wrong.[5] First, the Governor was not regulating the contracts but was exercising his police

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5. As with the Eleventh Amendment argument, we address here only the major points in Duke's opposition, and in so doing, we do not concede that Duke is correct on any point we do not specifically address.

powers to protect the health and welfare of the state's residents. Second, the Governor's orders were not preempted because FERC had provided that California law governed the contracts.

The Governor was not attempting to "regulate" the contracts. The Governor was exercising his emergency powers to insure that Duke continued to provide electricity pursuant to the terms of the contracts and that Duke was paid for that electricity as provided in the contracts.[6] The Governor's actions were not unconstitutional. As Justice Holmes stated, "Contracts are made subject to the police power of the State." *Marcus Brown Holding Co. v. Feldman*, 256 U.S. 170, 198 (1921); *see also Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 241 (1934). The Ninth Circuit erred because it completely ignored California's sovereign interest in exercising its legitimate police powers over contracts that were vital to the health and welfare of the state's residents. Nothing in the Federal Power Act can be read as showing that Congress intended to abrogate a state's right to exercise its police powers in an emergency. In the absence of express congressional intent, no statute should be read to abrogate such a fundamental state power.

The Ninth Circuit's analysis also missed the mark because it ignored the terms of the FERC-approved tariffs. The tariffs have more than "choice-of-law" provisions. The relevant provisions of the tariff are jurisdictional. They expressly establish that the tariff shall be governed by "the law of the State of California." Pet.App. at A55, A56. FERC did not require that

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6. And if by commandeering the contracts the Governor took Duke's private property causing Duke injury, then state law provided the means by which Duke can seek compensation. However, we do not concede that Duke had a protected security interest or that the Governor's order actually took any of Duke's property.

federal law govern the tariff but instead allowed for the application of California law. Therefore, exclusive federal jurisdiction is not present in this action.[7]

Moreover, even if FERC's jurisdiction might be exclusive, it is not under a specific obligation to assert that jurisdiction. *See New York v. Federal Energy Regulatory Com'n*, 122 S.Ct. 1012, 1028 (2002). Through its approval of the CalPX tariffs, FERC acknowledged the role of the state and of state law here. The Governor in commandeering the contracts was acting pursuant to this FERC-recognized role and thus the commandeering of the contracts was not preempted.

CONCLUSION

There is no doubt that California faced a real crisis at the time Governor Davis commandeered these contracts. In doing so, he exercised a basic element of state sovereignty, *i.e.*, to protect the public in the midst of a crisis. The decision of the Ninth Circuit raises grave issues concerning the Eleventh Amendment because of the extent to which it limits the ability of a governor to respond in a crisis. We respectfully urge this Court to grant the petition for writ of certiorari in order that those issues may be resolved.

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7. In a footnote, Duke asserts that our discussion of the tariff provisions on governing law is a new argument. Duke Opp. at 13, fn.7. We disagree. Duke's entire action rested on how the tariff was to be interpreted and applied, and our discussion represents only another aspect of application of the tariff. In any event, the effect of these tariff provisions is purely legal, and even if new, this Court may address them. *See Bellotti v. Baird*, 428 U.S. 132, 143 fn.10 (1976).

Respectfully submitted,

BILL LOCKYER, Attorney General
of the State of California
PETER SIGGINS
Chief Deputy Attorney General
RICHARD M. FRANK
Chief Assistant Attorney General
MORRIS BEATUS
Senior Assistant Attorney General
JOHN A. SAURENMAN*
Supervising Deputy Attorney General

Attorneys for Petitioner, Gray Davis,
Governor of the State of California
* Counsel of Record

APPENDIX J

BARRY R. OSTRAGER (State Bar No. 183770)
SETH A. RIBNER (State Bar No. 178030)
STEVEN H. BERGMAN (State Bar No. 180542)
SIMPSON THACHER & BARTLETT
10 Universal City Plaza, Suite 1850
Universal City, CA 91608
Telephone: (818) 755-7000
Facsimile: (818) 755-7009

JOEL B. KLEINMAN (*pro hac vice*)
GEOFFREY BESTOR (*pro hac vice*)
DICKSTEIN SHAPIRO MORIN & OSHINSKY
2101 L Street, N.W.
Washington, D.C. 20037-1526
Telephone: (202) 785-9700
Facsimile: (202) 887-0689

Attorneys for Defendant/Cross-Complainant
DUKE ENERGY TRADING and MARKETING, L.L.C.

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SACRAMENTO

INVERSE CONDEMNATION CASES	Judicial Council Coordination Proceeding No. 4203
This document relates to:	Before the Hon. James T. Ford
PEOPLE OF THE STATE OF CALIFORNIA, acting by and through the Department of Water Resources,	Civ. No. 01AS05497
Plaintiff,	**CROSS-COMPLAINT FOR VIOLATION OF THE SUPREMACY AND CONTRACTS CLAUSES OF THE UNITED STATES AND CALIFORNIA CONSTITUTIONS, FOR**

v.	)	TAKINGS UNDER THE
ACN ENERGY, INC., et al.	)	UNITED STATES AND CALIFORNIA
Defendants.	)	CONSTITUTIONS, AND FOR INVERSE
	)	CONDEMNATION
DUKE ENERGY TRADING & MARKETING, L.L.C.,	)	
Cross-Complainant,	)	
v.	)	
PEOPLE OF THE STATE OF CALIFORNIA, acting by and through the Department of Water Resources	)	
Cross-Defendant.	)	

Duke Energy Trading and Marketing, L.L.C. ("Duke Energy"), by its attorneys, cross-complains against Plaintiff and Cross-Defendant, the People of the State of California, acting by and through the Department of Water Resources (the "State of California"), as follows:

NATURE OF THE ACTION

1. In early February 2001, Gray Davis, Governor of the State of California, issued two Executive Orders purporting to "commandeer" certain valuable contracts to purchase electricity supplied by Duke Energy and other

wholesale energy suppliers. These contracts, known as block forward contracts, committed the suppliers to deliver electricity in the future at prices significantly below the then-current market price for similar future deliveries. The block forward contracts were all entered on the California Power Exchange (the "Cal PX"), California's now defunct wholesale power exchange, and were subject to detailed tariffs approved by the Federal Energy Regulatory Commission (the "FERC"). These federal tariffs regulated the wholesale purchase and sale of electricity in California pursuant to the Federal Power Act, 16 U.S.C. § 824, *et seq.*

2. At the time of the Governor's seizure orders, Southern California Edison ("Edison") and Pacific Gas & Electric ("PG&E"), the buyers on the block forward contracts, had already defaulted on their obligations to pay for hundreds of millions of dollars of power purchased through the Cal PX. Pursuant to the applicable tariff provisions, the Cal PX was in the process of liquidating Edison's and PG&E's forward contracts to cover their defaults to energy suppliers. The proceeds gained from the liquidation of the contracts were to be applied to the losses suffered by the Cal PX participants, such as Duke Energy, that had sold and delivered power to Edison and PG&E. The Governor's seizure deprived the suppliers of their remedy under the federal tariffs to proceed against the security that secured the utilities' prior energy purchases.

3. In February 2001, Duke Energy filed suit against the Governor in federal court seeking a declaration that the Governor's seizure of the block forward contracts was illegal under federal law and an injunction forbidding the

Governor from interfering with the liquidation of the contracts. On September 20, 2001, the United States Court of Appeals for the Ninth Circuit ruled that the Governor's seizure orders violated the Supremacy Clause of the United States Constitution because, by preventing the liquidation of the block forward contracts, they nullified the security and default provisions of the FERC-approved tariff and thus impermissibly intruded into an area subject to exclusive federal jurisdiction. *See Duke Energy Trading and Marketing, L.L.C. v. Davis*, 267 F.3d 1042 (9th Cir. 2001).

4. In this Cross-Complaint, Duke Energy asserts that it is entitled to be compensated by the State for damages suffered and injury incurred as the result of the Governor's illegal seizure orders. The ruling of the United States Court of Appeals for the Ninth Circuit is conclusive on the issue of the illegality of the seizure orders. In addition to the basis for the Ninth Circuit's ruling – the Supremacy Clause of the United States Constitution – the Governor's seizure orders were also illegal under the Contracts Clauses of the United States and California Constitutions and the Takings Clauses of the United States and California Constitutions. Duke Energy is also entitled to compensation because the Governor's illegal seizure orders constituted an inverse condemnation under California law and because, to the extent applicable, the Emergency Services Act, Cal. Gov. Code § 8572 requires the State to pay "just compensation" for the seized contracts.

THE PARTIES

5. Defendant and cross-complainant Duke Energy is a Delaware limited liability corporation with its principal place of business in Houston, Texas. Duke Energy is a supplier of wholesale power in California. Duke Energy was the largest supplier of power through forward contracts in the Cal PX forward market.

6. Plaintiff and cross-defendant State of California is a public governmental entity organized, existing, and operating under the Constitution and the statutes of the State of California. The Department of Water Resources is an agency of the State of California with its principal offices in Sacramento County. At the direction of the Governor, DWR took delivery of the energy supplied under the seized block forward contracts.

THE CALIFORNIA ELECTRICAL POWER MARKET

7. In 1996, the State of California enacted Assembly Bill 1890 ("AB 1890"), which is codified in various sections of the California Public Utilities Code. AB 1890 established the Cal PX, which, until January 30, 2001, operated day-ahead and day-of markets for the purchase and sale of electricity. AB 1890 also established the California Independent System Operator ("Cal ISO") to operate the transmission systems owned by the three investor owned utilities, including Edison and PG&E. The Cal ISO operates a real-time market for the purchase and sale of energy to meet demand not met through bilateral contracts and the markets operated by the Cal PX.

8. The purchases and sales of electricity in the markets administered by the Cal PX and the Cal ISO are for subsequent resale (*i.e.*, involve wholesale purchases of electricity). The Federal Power Act provides for exclusive federal jurisdiction over wholesale sales of electricity. *See* 16 U.S.C. § 824. Because of this exclusive federal jurisdiction, the creation and operation of the Cal PX and Cal ISO required approval of the FERC. The FERC approved the formation of these entities and the many other aspects of the restructuring of the California wholesale energy market as part of a broader FERC-led federal effort to restructure wholesale electricity markets nationwide. *See* Regional Transmission Organizations, Order No. 2000, F.E.R.C. Stats. & Regs. ¶ 31,089 (1999); Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, Order No. 888, F.E.R.C. Stats. & Regs., Regs. Preambles ¶ 31,036, 61 Fed. Reg. 21,540 (May 10, 1996). Both the Cal PX and the Cal ISO operate under and are governed by tariffs filed with the FERC that may not be changed without FERC approval. *See* 15 U.S.C. § 824(d).

THE CAL PX BLOCK FORWARD MARKET

9. Some time after the commencement of the Cal PX and Cal ISO-administered markets, the Cal PX expanded its offerings beyond the day-ahead and day-of markets to include so-called "block forward" contracts. Block forward contracts are contracts for delivery in future months. Because energy delivered under the block forward contracts is also for resale, the block forward market and contracts are also subject to exclusive federal jurisdiction.

10. The two Cal PX markets – the day-ahead/day-of market and the block forward market – are governed by tariffs on file with and approved by the FERC. The day-ahead/day-of market, known as the "Core" Market, is governed by the "California Power Exchange Corporation FERC Electric Service Tariff No. 2, First Revised Volume No. 2, Effective August 1, 2000" (the "PX Tariff"). The block forward market, known as the "CTS Market" (for "Cal PX Trading Services") is governed by the "Block-Forward Market Rate Schedule FERC No. 1, Effective August 1, 2000" (the "CTS Rate Schedule"). Participants in the Cal PX markets are required to sign Participant Agreements that bind the participants to the terms of the tariff. *See* CTS Rate Schedule, App. 4.

11. The Cal PX tariffs are carefully structured to provide participants with the assurances needed to operate in an anonymous exchange. For example, participants in the Cal PX markets are required to meet stringent creditworthiness requirements. *See* Information Guide for the CTS Markets, Dec. 8, 2000, §§ 3.2.4, 3.2.4.1, and 3.2.8. Under the PX Tariff, failure to provide required collateral "shall result in the application of liquidation and default procedures as currently in place in the PX Tariff, CTS Rate Schedule, Operating Manual or CTS Information Guide." PX Tariff, § 1.2. Default in any Cal PX market constitutes default in all of them. Default by a participant gives the Cal PX the right to draw on the collateral and take other steps, including liquidating any block forward contracts to which the participant is a party. *See* CTS Rate Schedule, § 6.7.6. Thus, participants in the CTS markets have significant protections against the financial consequences of default of another participant.

12. Duke Energy was the largest single supplier of power on the Cal PX CTS Market, representing over 43% of all the volume of open CTS Market contracts as of early February 2001. At the time of the Governor's seizures of the contracts in early February 2001, the outstanding block forward contracts to which Edison and PG&E were parties had a liquidation value of in excess of $1 billion, a value that exceeded the face value of the contracts by more than $700 million. At the time of the seizures, the value of the outstanding block forward contracts for which Duke was the supplier exceeded the face value of those contracts by more than $250 million.

THE ATTEMPT TO LIQUIDATE THE BLOCK FORWARD CONTRACTS

13. In January 2001, Edison and PG&E began defaulting on their payment obligations to the Cal PX. In addition, both companies had their credit ratings downgraded by credit rating agencies, with the result that the Cal PX tariff required the companies to post collateral for their transactions. Neither company did so, and thus were further in default under the Cal PX tariffs.

14. Among the remedies available to the Cal PX in the event of a default by a purchaser in the Cal PX markets was liquidation or sale of the purchaser's block forward contracts. *See* CTS Trading Rules, § 6.7.6. The Cal PX thus undertook to sell or liquidate Edison's and PG&E's block forward contracts.

15. On January 19, 2001, Edison sought a temporary restraining order in the Superior Court of the State of California for the County of Los Angeles to block the

liquidation. That request was denied. At a preliminary injunction hearing on Edison's application held on January 24, the State of California intervened, and requested that a preliminary injunction be entered while Governor Davis contemplated action under the California Emergency Services Act. A preliminary injunction was entered on this basis, to expire on February 2, 2001.

16. On January 25, 2001, the State of California, with the consent of the Cal PX, obtained a similar order covering PG&E's block forward contracts on the basis of the order entered with respect to Edison's contracts.

THE GOVERNOR'S COMMANDEERING ORDERS

17. On February 2, 2001, the Los Angeles Superior Court denied Edison's and the Governor's request to continue the preliminary injunction, which was scheduled to expire at 4:00 p.m. that day. In response, on the afternoon of February 2, Governor Davis issued an Executive Order, which was dated January 31, 2001, with the following operative language.

> Pursuant to section 8572 of the California Emergency Services Act, it is ordered that the contracts and trades in the market for the sales and purchases of forward contracts and trades for electricity (known as the "Block Forward" market) for the delivery of electricity possessed by Southern California Edison Company, a corporation organized and existing under the laws of the State of California with its principal place of business in California, and subject to actions, including liquidation, by the California Power

> Exchange Corporation, a non-profit public benefit corporation organized and existing under the laws of the State of California, is hereby commandeered by the State of California to be held subject to the control and coordination of the State of California.

18. On February 5, 2001, Governor Davis issued a similar order purporting to commandeer PG&E's block forward contracts.

19. On February 8, 2001, Duke Energy filed a lawsuit against the Governor and the Cal PX (the Cal PX subsequently went into bankruptcy and was dismissed from the suit) in the United States District Court for the Central District of California challenging the Governor's seizure orders. Duke Energy asserted that the seizure orders violated the Supremacy Clause of the United States Constitution because they intruded on a sphere reserved to exclusive federal jurisdiction, and violated the Contracts Clause of the Constitution because they interfered with Duke Energy's contractual rights by preventing the liquidation of the block forward contracts. Duke Energy sought declaratory and injunctive relief prohibiting the Governor from interfering with the liquidation of the block forward contracts.

20. On April 30, 2001, the district court dismissed Duke Energy's suit against the Governor on the ground that the Governor was immune from suit in federal court under the Eleventh Amendment to the United States Constitution. Duke Energy appealed that determination to the United States Court of Appeals for the Ninth Circuit.

21. On September 20, 2001, the United States Court of Appeals for the Ninth Circuit ruled that the Governor

was, in fact, amenable to sit in federal court. In addition, the Court found that the Governor's orders commandeering the block forward contracts "directly nullify the security and default mitigation provisions of the FERC-approved [tariff], and hence cross the 'bright line' between state and federal jurisdiction established by the [Federal Power Act]." *Duke Energy Trading and Marketing, L.L.C. v. Davis,* 267 F.3d at 1056. The Court of Appeals further found that "Governor Davis's [commandeering] orders constitute an impermissible intrusion into FERC's teritory" and "deprived wholesale suppliers of their FERC-required collateral for past transactions." 267 F.3d at 1057-1058. The Court of Appeals thus held:

> [B]y commandeering the block forward contracts, Duke (and, derivatively, the Cal PX) lost its FERC-protected right to standard financial protection, i.e., to liquidate its collateral if the buyers default on their obligations. It is Governor Davis's interference with the block forward contracts' security provisions that is preempted by the federal scheme. FERC preempts regulation of the contracts' economics of administration, which, by destroying Duke's ability to exercise its rights to assure payment for third-party sales, is exactly why Governor Davis's executive order cannot stand. Hence Governor Davis's commandeering orders to the extent that they conflict with FERC requirements are void under the Supremacy Clause of the United States Constitution.

267 F.3d at 1058-1059.

22. Following the Governor's seizure of the block forward contracts, under compulsion of the seizure

orders, Duke Energy delivered the energy to DWR, and DWR paid Duke Energy the contract price for the energy. However, as noted by the Ninth Circuit,

> [I]t is not enough that California agrees to pay the same rate to Duke or requires Duke to continue to supply electricity for a duration no longer than the block forward contracts provide. Indeed, in that respect, California is a complete substitute for SCE and PG&E. However, by commandeering the block forward contracts, Duke (and, derivatively, the CalPX) lost its FERC-protected right to standard financial protection, i.e., to liquidate its collateral if the buyers default on their obligations. It is Governor Davis's interference with the block forward contract provisions that is preempted by the federal scheme.

267 F.3d at 1058.

23. Had the Governor not seized the block forward contracts, those contracts would have been liquidated in early February 2001. The liquidation of the contracts would have resulted in hundreds of millions of dollars being made available to cover the defaults of Edison and PG&E.

AS AND FOR A
FIRST CAUSE OF ACTION
(Violation of Supremacy Clause of United States Constitution)

24. Duke Energy hereby reasserts and realleges each and every allegation of paragraphs 1-23 herein.

25. Pursuant to 16 U.S.C. § 824(b)(1), wholesale sales of electricity in interstate commerce are subject to

the exclusive jurisdiction of the United States. The Governor's seizures of the block forward contracts impermissibly intruded on an area reserved to exclusive federal jurisdiction and accordingly violated the Supremacy Clause of the United States Constitution.

26. Duke Energy suffered damages as the result of the unlawful seizure of the block forward contracts and is entitled to compensation for the value thereof as set forth in the prayer for relief.

AS AND FOR A
SECOND CAUSE OF ACTION
(Violation of Fifth and Fourteenth Amendments of the United States Constitution and Article 1, Sections 1 and 19 of the California Constitution)

27. Duke Energy hereby reasserts and realleges each and every allegation of paragraphs 1-26 herein.

28. Duke Energy possessed property rights and contractual rights in the block forward contracts seized by the Governor. These property and contractual rights included the right to liquidate the contracts in the event Edison and PG&E defaulted on their payments. The Governor's actions seizing the contracts deprived Duke Energy of the security value of the contracts.

29. The Governor stated that his commandeering the block forward contracts was for the public use. Neither the Governor nor the State has compensated, or sought to compensate, Duke Energy for the security value of the seized contracts.

30. The Governor's seizure orders thus constituted unlawful takings under the Fifth and Fourteenth Amendments of the United States Constitution and under Article 1, Sections 1 and 19 of the California State Constitution.

31. Accordingly, Duke Energy is entitled to the value of the property taken by Governor Davis as set forth in the prayer for relief.

AS AND FOR A
THIRD CAUSE OF ACTION
(Inverse Condemnation)

32. Duke Energy hereby reasserts and realleges each and every allegation of paragraphs 1-31 herein.

33. Duke Energy had a legally enforceable property interest in the block forward contracts.

34. The Governor's intent in seizing the contracts was to prevent Duke Energy and the Cal PX from liquidating the contracts. As a result of the seizures, Duke Energy and the Cal PX were unable to liquidate the block forwards and apply the proceeds of that sale to repay the monies owed by Edison and PG&E. At the time of the seizure, the Governor stated explicitly that the contracts were seized for public use.

35. Duke Energy made the Governor aware at the time, and since, of its opposition to the seizure orders and to the continuing damage being caused to Duke Energy's property.

36. Duke Energy attempted all means of reversing the Governor's actions, and the State allowed no means of administrative review for the Governor's actions.

37. Accordingly, Duke Energy is entitled to the value of the property taken by Governor Davis as set forth in the prayer for relief.

AS AND FOR A
FOURTH CAUSE OF ACTION
(Violation of Article 1, Section 10 of the United States Constitution and Article I, Section 9 of the California Constitution)

38. Duke Energy hereby reasserts and realleges each and every allegation of paragraphs 1-37 herein.

39. Duke Energy had legally enforceable contractual rights in the block forward contracts.

40. The Governor's seizure of the block forward contracts impaired Duke Energy's contractual rights under the block forward contracts, and that impairment was substantial.

41. Governor Davis's Executive Orders purporting to commandeer the block forward contracts constituted an impairment of the obligation of contract in violation of Article I, Section 10 of the United States Constitution and Article I, Section 9 of the California Constitution.

42. Accordingly, Duke Energy is entitled to compensation for the unlawful impairment of Duke Energy's contractual rights as set forth in the prayer for relief.

AS AND FOR A
FIFTH CAUSE OF ACTION
(Emergency Services Act, Cal. Gov. Code § 8572)

43. Duke Energy hereby reasserts and realleges each and every allegation of paragraphs 1-42 herein.

44. The Governor's seizure orders were issued under the authority of the Emergency Services Act, Cal. Gov. Code §§ 8550, *et. seq.*

45. Section 8572 of the Emergency Services act requires the State to pay "just compensation" for property seized under the Act. Under California law, "just compensation" is fair market value.

46. Accordingly, Duke Energy is entitled to just compensation equal to the fair market value of the contracts at the time of their seizure as set forth in the prayer for relief.

WHEREFORE, Plaintiff Duke Energy prays for the following relief and judgment:

A. For all of the causes of action asserted, the appropriate measure of damages, whether viewed as just compensation, damages, or the value of the property in question, is the amount of money that would have been realized had the block forward contracts been liquidated on the dates of their seizure by the Governor. Accordingly, Duke Energy is entitled to judgment against the State of California for the fair market value of the block forward contracts at the time of their seizure, an amount in excess of $700 million.

B. For attorneys' fees and expenses incurred in this action to the extent allowable.

C. For costs of suit incurred in this action.

D. For such other and further relief as this Court may deem proper.

Dated: April 15, 2002

SIMPSON THACHER & BARTLETT

DICKSTEIN SHAPIRO MORIN & OSHINSKY

By /s/ Seth A. Ribner
Seth A. Ribner

Attorneys for Defendant/
Cross-Complainant
DUKE ENERGY TRADING &
MARKETING L.L.C.